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PUBLIC UTILITIES
 COMMISSION

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FILED

BEFORE THE PUBLIC UTILITIES COMMISSION
 OF THE STATE OF HAWAII

In the Matter of the Application of)
)
 HAWAIIAN ELECTRIC COMPANY, INC.)
)
 For Approval and/or Modification of)
 Demand-Side and Load Management)
 Program and Recovery of Program)
 Costs and DSM Utility Incentives.)
 _____)

DOCKET NO. 05-0069

DIVISION OF CONSUMER ADVOCACY'S

REPLY BRIEF

AND

CERTIFICATE OF SERVICE

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TABLE OF CONTENTS

I.	<u>CONSUMER ADVOCATE OPENING BRIEF ISSUE 1 – CONCERNING DSM GOALS, MOST PARTIES AGREE THAT DSM GOALS SHOULD BE ESTABLISHED FOR EACH UTILITY THROUGH THE INTEGRATED RESOURCE PLANNING PROCESS.....</u>	2
A.	SUMMARY OF THE PARTIES’ POSITION ON THE ISSUE	2
B.	DISCUSSION OF THE MERITS OF ESTABLISHING UTILITY-SPECIFIC GOALS THROUGH THE IRP PROCESS	3
1.	It is important to determine the purpose for establishing the DSM goals that each utility will be expected to achieve	3
2.	Problems with HSEA’s and HREA’s proposal to establish statewide goals	4
a.	HREA’s recommended statewide DPS is arbitrary	5
b.	HSEA’s recommendation appears to favor the adoption of utility specific versus statewide goals	5
3.	Summary	7
C.	THE COMMISSION SHOULD NOT ADOPT THE CALIFORNIA DEFINITION OF DEMAND – SIDE MANAGEMENT TO REDUCE HAWAII’S DEPENDENCE ON IMPORTED FOSSIL FUELS TO GENERATE ELECTRICITY AS HSEA CLAIMS	8
II.	<u>CONSUMER ADVOCATE OPENING BRIEF ISSUE 2 – CONCERNING THE APPROPRIATE MARKET STRUCTURE FOR THE STATE, THE PARTIES DISAGREE AS TO WHETHER THE COMMISSION SHOULD ADOPT A NON-UTILITY THIRD-PARTY DSM MARKET STRUCTURE OR A HYBRID UTILITY/THIRD-PARTY DSM MARKET STRUCTURE</u>	10
III.	<u>CONSUMER ADVOCATE OPENING BRIEF ISSUE 2 – HECO’S CONCERNS REGARDING THE PUBLIC BENEFITS FUND ARE WITHOUT MERIT</u>	13
IV.	<u>CONSUMER ADVOCATE OPENING BRIEF ISSUES 3 AND 4 - CONCERNING THE METHOD OF COST RECOVERY, MOST PARTIES AGREE THAT DSM PROGRAM COSTS SHOULD BE RECOVERED THROUGH A SURCHARGE MECHANISM</u>	14
A.	SUMMARY OF THE PARTIES’ POSITION	14

B.	IN ORDER TO DETERMINE THE APPROPRIATE MECHANISM FOR COST RECOVERY, ONE MUST DETERMINE WHETHER THE UTILITY IS ENTITLED TO RECOVER ALL COSTS INCURRED TO ADMINISTER, DESIGN, IMPLEMENT AND MONITOR DSM PROGRAMS	16
V.	<u>CONSUMER ADVOCATE OPENING BRIEF ISSUE 5 - CONCERNING THE NECESSITY OF DSM-RELATED INCENTIVES, THE PARTIES DISAGREE AS TO WHETHER UTILITIES NEED DSM-RELATED INCENTIVES TO PURSUE ENERGY EFFICIENCY AND DSM PROGRAMS IN THEIR SERVICE TERRITORIES</u>	21
A.	SUMMARY OF THE PARTIES' POSITION ON THE ISSUE	21
B.	DISCUSSION AS TO WHY INCENTIVES TO AGGRESSIVELY PURSUE THE IMPLEMENTATION OF DSM AND ENERGY EFFICIENCY MEASURES FOR THE HECO COMPANIES SHOULD BE TERMINATED.....	22
C.	PROVIDING INCENTIVES THAT ARE AKIN TO THE RETURN ON RATE BASE FAILS TO RECOGNIZE THE UNDERLYING BASIS FOR PROVIDING SUCH RETURN, IS UNREASONABLE AND IS INCONSISTENT WITH RATEMAKING PRINCIPLES.....	23
D.	THE CONSUMER ADVOCATE'S CONCERNS WITH HECO'S NOVEMBER 3 FILING ON DSM PROGRAM INCENTIVES--HECO'S EXHIBIT C.....	26
1.	Introduction.....	26
2.	Analysis.....	28
E.	SUMMARY.....	29
VI.	<u>THE CONSUMER ADVOCATE OPPOSES REVENUE DECOUPLING</u>	30
VII.	<u>THE PARTIES AGREE THAT THE COMMISSION SHOULD APPROVE HECO'S PROPOSED DSM PROGRAMS</u>	31
A.	HECO'S PROPOSED DSM PROGRAMS	31
1.	There are deficiencies in the methods by which HECO's proposed DSM program package was developed that should be remedied prospectively.....	33
a.	Other Parties' Positions	34
b.	Discussion / Recommendations.....	35

2.	HECO's proposed programs appear to be a reasonable means of addressing HECO's current, urgent system needs and thus should be approved by the Commission	37
a.	Other Parties' Positions	37
b.	Conclusions / Recommendations	38
3.	The Consumer Advocate's review of DSM program designs results in limited recommendations for improvements	39
a.	Other Parties' Positions	39
b.	Conclusions / Recommendations	42
c.	HREA's Sea Water Air Condition Proposal.....	44
d.	RCEA should not be approved as a DSM program since HECO has failed to demonstrate the cost benefits of the expenditures	48
B.	MONITORING AND EVALUATING DSM MEASURES SHOULD CONTINUE THROUGH THE INITIATION OF COMMISSION DOCKETS.....	49
VIII.	<u>CONCLUSION</u>	52

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DIVISION OF CONSUMER ADVOCACY'S

REPLY BRIEF

Pursuant to the regulatory schedule approved by the Public Utilities Commission ("Commission") in Order No. 22251, as modified by a correspondence approved by the Commission on April 13, 2006, the Division of Consumer Advocacy, Department of Commerce and Consumer Affairs, State of Hawaii ("Consumer Advocate"), hereby submits the following Reply Brief in Docket No. 05-0069, the Commission's Energy Efficiency Docket.

I. CONSUMER ADVOCATE OPENING BRIEF ISSUE 1 – CONCERNING DSM GOALS, MOST PARTIES AGREE THAT DSM GOALS SHOULD BE ESTABLISHED FOR EACH UTILITY THROUGH THE INTEGRATED RESOURCE PLANNING PROCESS.

A. SUMMARY OF THE PARTIES' POSITION ON THE ISSUE.

In its Opening Brief filed with the Commission on October 25, 2006, the Consumer Advocate recommended that the Commission set aggressive, yet achievable, goals for energy efficiency efforts in the State using the integrated resource planning ("IRP") process adopted by the Commission in Decision and Order No. 11523.¹ Consumer Advocate Opening Br. at 21-24. Hawaiian Electric Company, Inc. ("HECO"), Hawaiian Electric Light Company, Inc. ("HELCO"), Maui Electric Company, Limited ("MECO") (collectively, "HECO Companies"), Kauai Island Utility Cooperative ("KIUC"), the Gas Company, L.L.C. ("TGC"), and the County of Maui ("COM") supported the Consumer Advocate's recommendation in this respect. See HECO Opening Br. at 15-16; KIUC Opening Br. at 9-13; TGC Opening Br. at 5-8; County of Maui Opening Br. at 8. The Department of Defense ("DOD") and the Rocky Mountain Institute ("RMI") took no position on the issue of setting statewide energy efficiency goals for Hawaii.

Only three parties in the instant proceeding advocated the establishment of statewide measures. The Hawaii Renewable Energy Alliance ("HREA") suggested that the Commission establish and implement a Demand-Side Management ("DSM") Portfolio Standard ("DPS") as a mechanism to attain energy efficiency and DSM goals in the State. HREA Opening Br. at 4 and 6. The Hawaii Solar Energy Association

¹ The Commission modified portions of its "Framework For Integrated Resource Planning" ("IRP Framework") in Decision and Order No. 11630, filed on May 22, 1992.

(“HSEA”) stated that it favored the establishment of DSM goals for the State. HSEA Opening Br. at 15. In its Opening Brief filed with the Commission, Life of the Land (“LOL”) asserted that the State “should not have goals[,] but requirements[,]” for energy efficiency efforts in Hawaii. LOL Opening Br. at 7.²

B. DISCUSSION OF THE MERITS OF ESTABLISHING UTILITY-SPECIFIC GOALS THROUGH THE IRP PROCESS.

1. It is important to determine the purpose for establishing the DSM goals that each utility will be expected to achieve.

Before the Commission can determine what the energy efficiency or DSM goals should be, the Commission must determine its purpose in setting such goals. Once this determination is made, the differing proposals of the Parties can be properly evaluated.

To illustrate the point, if one determines that the purpose of the DSM goals is to communicate to the rest of the country Hawaii’s view of how much DSM the state of Hawaii should be able to achieve, then statewide goals may be appropriate. The question becomes, however, whether such broad goals are meaningful to the entity to which they would apply. If the DSM goals are arbitrarily constructed, or deliberately set too high or too low, they will be ignored. Furthermore, unless there is some clear way to assign responsibility for meeting the goals to specific entities, broader statewide goals will cease to have much value. That is, if multiple utilities are collectively responsible for meeting a particular goal, then a collective failure to meet the goal likely would result in “finger pointing” regarding who was responsible.

² HECO, DOD, LOL, HSEA, HREA, HELCO, MECO, KIUC, TGC, and the Consumer Advocate are parties to this proceeding (“Parties”). The COM and the County of Kauai (“COK”) are participants in this proceeding (“Participants”).

Alternatively, if the purpose of establishing DSM goals is to: (1) communicate each utility's commitment to important legislative initiatives (or, in the event that a third-party provider is installed, each island's commitment to legislative initiatives), and (2) provide stakeholders with a clear view of the level of energy and capacity savings to be achieved by each utility, as noted in the Consumer Advocate's Final SOP (at 32), the goals that are established would best represent "aggressive, yet achievable" levels of DSM measures. In order to send that message more forcefully, the Commission could also implement a reward/penalty structure for the achievement of such goals.

The Consumer Advocate agrees with the EPA that the purpose of establishing DSM goals should be to represent "aggressive, yet achievable" levels of DSM measures that should be implemented by each utility authorized to provide service in the State. Given the unique characteristics of each utility, however, the goals must be established on an island-by-island basis to be meaningful and serve as the basis for accountability. Such goals should be determined in the IRP process pursuant to the Commission's IRP Framework. See Consumer Advocate's Final SOP at 32.

2. Problems with HSEA's and HREA's proposal to establish statewide goals.

As noted above, HREA and HSEA recommended the establishment of statewide goals that would be applicable to each utility. As will be discussed below, there are concerns with the reasonableness of the recommended action.

a. HREA's recommended statewide DPS is arbitrary.

HREA did not specify the means by which energy efficiency and DSM goals will be set under HREA's DPS. Instead, HREA, simply recommends a 1.0% goal on an on-going basis over a 30-year period. See HREA Opening Br. at 6. The concern with HREA's recommendation (as HREA apparently recognizes) is the difficulty in achieving the recommended percentage without a modification to the definition of DSM programs. Furthermore, HREA appears to recognize that each island has different load profiles and demand requirements, but would leave it up to a competitive bidding process to demonstrate "how that requirement could be meet [sic] on all islands, perhaps exceeded on one or more of the islands." See HREA Opening Br. at 7.

Clearly, there is no basis to support HREA's recommended 1% DPS goal in the record, yet HREA recommends a one-size-fits-all approach and would have the third-party administrator be responsible for determining how the goal can best be achieved. See HREA Opening Br. at 7. The Consumer Advocate contends that HREA's recommended statewide DPS is arbitrary, and represents a goal that is either too stringent, or too lax. Finally, HREA's recommended statewide goal fails to consider the unique characteristics of each island, which will make it difficult to assess responsibility for achieving the goal.

b. HSEA's recommendation appears to favor the adoption of utility specific versus statewide goals.

HSEA recommends a fixed percentage as a statewide goal and then recommends that the definition of energy efficiency as set forth in the Commission's IRP Framework be modified to ensure that the goal is achievable. Like HREA, however,

HSEA did not suggest a means by which energy efficiency or DSM goals can be set by the Commission. Rather, HSEA merely selects what appears to be an arbitrary number that reflects a view of the initial annual load reduction to be achieved by the State's utilities. See HSEA Opening Br. at 15. (recommending that Hawaii's DSM goal should reflect an initial annual load reduction of between 0.6% and 1.0% of a utility's load).

It appears that HSEA's recommendation is intended to encourage the pursuit of certain customer-sited generation resources. If the Consumer Advocate's observation is correct, then a change in the definition of energy efficiency or DSM measure is not necessary to achieve HSEA's desired result. Rather the pursuit of these types of supply-side resources can readily be accomplished in the IRP process, pursuant to the Commission's IRP Framework. For example, specific types and quantities of customer-sited generation options could be identified and approved by the Commission as part of a utility's five-year action plan.³

HSEA also appears to recognize that the recommended statewide goals would need to be modified over time. HSEA states in its Opening Brief that the goal "should reflect an initial annual reduction in electricity load somewhere between 0.6% and 1.0%. The total reduction in sales that results from the utility's DSM programs can be considered a function of the accuracy and viability of the [Maximum Achievable Potential ("MAP")] planning process." HSEA Opening Br. at 15.

The Consumer Advocate contends, however, that the MAP planning process is one which should take into consideration the unique characteristics of each utility.

³ The Consumer Advocate anticipates that goals for demand-side resources might be developed and approved through a very similar process in IRP proceedings.

Thus, the results of MAP planning processes will differ from utility to utility, and the MAP results established for one utility (e.g., HECO) will differ from those of another utility (e.g., KIUC). As a result, HSEA's proposal to develop the statewide goals using MAP results implicitly appears to favor the adoption of utility-specific DSM goals. HSEA has not explained how the MAP analysis for each island will translate into a "one-size-fits-all" statewide goal that would be applicable to each of Hawaii's utilities.

3. Summary.

HSEA and HREA have not offered any factual information to demonstrate the reasonableness of their recommended statewide goals. Furthermore, HSEA and HREA have not addressed the concerns expressed by the Parties that statewide goals will not necessarily be aligned with the unique characteristics of each utility that may impact the levels of energy efficiency savings that can reasonably be achieved (i.e., aggressive but attainable results). Nothing offered by HSEA or HREA in their Opening Briefs should convince the Commission that developing statewide DSM goals is reasonable.

Thus, the Consumer Advocate contends that the Commission should require each utility to develop the DSM and energy efficiency goals in the IRP process. This would ensure that the energy efficiency and DSM goals are meaningful, and represent aggressive but attainable targets for each utility, in keeping with the EPA's recommendations. Furthermore, island-specific goals developed in the IRP process will enable the Commission to hold a specific party responsible for achieving the established goals.

C. THE COMMISSION SHOULD NOT ADOPT THE CALIFORNIA DEFINITION OF DEMAND – SIDE MANAGEMENT TO REDUCE HAWAII’S DEPENDENCE ON IMPORTED FOSSIL FUELS TO GENERATE ELECTRICITY, AS HSEA CLAIMS.

One difference between the Parties on Issue 1 is whether the definition of energy efficiency should be modified to include options that have traditionally been deemed to be “supply-side” resources, in order to encourage utilities to aggressively pursue these types of resources. HSEA recommends that the Commission modify the definition of DSM in the Commission’s IRP Framework and adopt the October, 2001 California Standard Practice Manual. See HSEA Opening Br. at 3. In support of its proposal, HSEA states that the existing definition of DSM will “severely limit Hawaii’s DSM program options regardless of administrative structure . . . [and] make it . . . more difficult for Hawaii to reduce its dependence on imported fossil fuels to generate electricity.” Id. In making its proposal, HSEA supports the inclusion of self-generation on the customer’s side of the meter as a DSM option. The COM agreed with HSEA’s proposal to adopt the California definition, but appears to focus its recommendation on the manner in which the resource can be used. The Consumer Advocate and KIUC recommend no change to the definition of energy efficiency or DSM.

The definition of DSM and energy efficiency does not need to be changed in order to encourage the aggressive installation of self-generation on the customer’s side of the meter. Rather, any concerns with the utility’s acceptance or resistance to the installation of such measures should be addressed in the IRP process, not by an “expanded definition” as proposed by HSEA. Furthermore, how a resource is used should not be reason for changing a definition. Both HSEA and the COM failed to provide evidence to demonstrate why a modification of the definition is necessary to

consider the need to aggressively pursue the installation of generation on the customer's side of the meter. Furthermore, HSEA and the COM failed to demonstrate why their concerns could not be appropriately addressed in the IRP process.⁴

The Consumer Advocate acknowledged in its Final SOP that the establishment of goals will encourage better DSM energy- and capacity-savings results. The Commission's IRP Framework requires each utility to set forth the goals and objectives to be achieved. It is thus reasonable to establish a goal that recognizes a higher level of penetration of supply-side resources located on the customer's side of the meter, without changing the DSM definition as HSEA proposes. The level of penetration of supply-side resources on the customer side of the meter is a matter that can be discussed in the advisory group meetings. Any disagreements with the plan that is filed with the Commission can be raised subsequent to the filing.

In conclusion, the Consumer Advocate asserts that the utilities should be required to establish goals on a resource-by-resource basis in the IRP process, rather than modify the definition of DSM and energy efficiency as set forth in the Commission's IRP Framework. This recommendation will ensure that there is no overlap between what is traditionally viewed as demand-side or energy efficiency options, and supply-side resources, while still accomplishing the result that appears to be intended by HSEA through its proposal to modify the DSM definition.

⁴ As noted above, implementation levels for specific types of customer-sited (and other) resources could be established through IRP processes.

II. CONSUMER ADVOCATE OPENING BRIEF ISSUE 2 – CONCERNING THE APPROPRIATE MARKET STRUCTURE FOR THE STATE, THE PARTIES DISAGREE AS TO WHETHER THE COMMISSION SHOULD ADOPT A NON-UTILITY THIRD-PARTY DSM MARKET STRUCTURE OR A HYBRID UTILITY/THIRD-PARTY DSM MARKET STRUCTURE.

In its Opening Brief, the Consumer Advocate recommended that, with the exception of KIUC, the Commission should assign responsibility for administering, designing, implementing, monitoring, and evaluating DSM programs to a non-utility third-party administrator consistent with Act 162, Session Laws of Hawaii 2006. See Consumer Advocate Opening Br. at 26-33. HREA, LOL, and the COM supported the Consumer Advocate's recommendation in this respect. See HREA Opening Br. at 8-11; LOL Opening Br. at 3; COM Opening Br. at 9.

TGC and KIUC recommended utility retention of the responsibility for administering, designing, implementing, monitoring and evaluating DSM programs. The COK and the Consumer Advocate agreed that KIUC's retention of these responsibilities is reasonable. The Consumer Advocate, however, opposes TGC's proposal to retain DSM program administration (when such programs are offered in the future). The reasons for the Consumer Advocate's opposition are the same as the reasons for the Consumer Advocate's support of non-utility third-party administration for the DSM programs to be offered by the HECO Companies. RMI recommended that TGC and KIUC retain the responsibility for administering, designing, implementing, monitoring and evaluating DSM programs.

HECO asserted that a third-party DSM administrator should be selected to serve customer segments that the HECO Companies find difficult to reach through existing DSM program options. HECO Opening Br. at 153-55. According to HECO, other

programs should be left under the administration of the HECO Companies, provided that the programs meet certain criteria. HECO suggests that the targeted customers will, on balance, be more effectively served if the programs remain under the HECO Companies' control. Id. at 148-153.

In its Opening Brief, RMI concurred with the market structure proposal made by HECO in HECO's Opening Brief. RMI Opening Br. at 7. HSEA also favored the proposals made by HECO and RMI in their Opening Briefs. HSEA Opening Br. at 15-16. TGC and DOD took no position on the issue of the appropriate DSM market structure for providing electric utility programs.⁵ See TGC Opening Br. at 8.

The reasons for utilizing a non-utility third-party provider were discussed at length in the Consumer Advocate's Opening Brief and will not be repeated here. Furthermore, many of the other parties supporting a non-utility third-party provider offered similar arguments as the Consumer Advocate. It should be noted that although DOD did not take a position on the matter, DOD offered factors that need to be considered as the transition occurs. The Consumer Advocate's Final SOP also identified similar factors that would require consideration.

The Consumer Advocate notes that, as discussed in its Opening Brief, adoption of HECO's proposal would put the non-utility third-party administrator in a difficult position should the Commission establish utility-specific DSM and energy efficiency goals and implement a reward/penalty mechanism for the achievement of such goals. Furthermore, the utility would be allowed to retain the easy to reach market, thereby

⁵ For KIUC's position, see n. 4, supra.

making it easier for the utility to achieve the established DSM or energy efficiency goal. As a result, the Consumer Advocate recommends against adoption of the hybrid structure proposed by HECO and RMI.

Act 162 recognizes and allows the recommended change in market structure. The reasons expressed by the Consumer Advocate, HREA, LOL, and COM support the recommended change in market structure (i.e., non-utility third-party administration) at this time. Furthermore, the challenges faced by the Consumer Advocate in ensuring that the HECO Companies do not “double recover” IRP and DSM related costs⁶ and the HECO Companies’ insistence on receiving incentive compensation to pursue DSM activities suggest that the time is right to change the manner in which energy efficiency and DSM programs are administered, designed, implemented, and evaluated in Hawaii. For all of the above reasons, the Consumer Advocate recommends that the Commission transfer all responsibility for the administration, design, implementation, and monitoring of DSM and energy efficiency programs to a non-utility third-party.

If the Commission decides not to adopt the Consumer Advocate’s recommendation, then the Commission should keep the status quo whereby the utility has sole responsibility for the administration, implementation, and monitoring of the DSM and energy efficiency programs. The Commission should not implement a hybrid structure as HECO and RMI suggest. The reason is because the party responsible for

⁶ See the Consumer Advocates Statement of Position filed in the IRP general planning cost recovery dockets (i.e., Docket Nos. 94-0316, 95-0362, 96-0431, 97-0358, 98-0339, 99-0338, 00-0360, 01-0409, 02-0359, 03-0276, and 04-0295 addressing the HECO Companies’ request to recovery certain 1995, 1996, 1997, 1998, 1999, 2000, 2001, 2002, 2003, 2004 and 2005 IRP general planning costs, respectively, through the IRP surcharge mechanism and the discussion on cost recovery mechanisms presented in Section IV. below.

the administration, implementation and monitoring of the DSM and energy efficiency measures should be held responsible for achieving the established goals. This could be done through a reward/penalty mechanism, as will be discussed in Section V. below.

III. CONSUMER ADVOCATE OPENING BRIEF ISSUE 2 – HECO’S CONCERNS REGARDING THE PUBLIC BENEFITS FUND ARE WITHOUT MERIT.

In its Opening Brief, HECO suggested that a public benefits fund should not be established by the Commission because “public benefit funds are vulnerable to raiding[] and funding levels are disconnected from the resource planning portfolio of energy efficiency and other resources.” HECO Opening Br. at 154 (footnotes omitted). HECO apparently premised its statements upon the National Action Plan for Energy Efficiency filed as one of HECO’s exhibits in the Energy Efficiency Docket. See Id. (citing to the July 2006 National Action Plan for Energy Efficiency, filed as Exhibit A to HECO’s filings).

In Act 162, the Legislature passed Hawaii Revised Statutes (“HRS”) § 269-A(b), which states, in relevant part, as follows: “[t]he moneys [deposited into the public benefits fund] shall not be available to meet any current or past general obligation of the State.” 2006 Haw. Sess. L. Act 162, § 1 at 640. Act 162 also provides that “[t]he fund administrator’s duties and responsibilities shall be established by the [Commission] by rule or order” Id. at 641 (HRS § 269-C(b)).

In response to HECO’s contentions that a public benefits fund will be vulnerable to raiding, the Consumer Advocate notes that Act 162 expressly prohibits the public benefits fund from being used to meet any current or past general obligation of the State. Id. at 640 (enacting HRS § 269-A(b)). Furthermore, pursuant to

HRS § 269-C(b), the Commission, by rule or order, may specify that the public benefits fund administrator shall play an active role in the development of a utility's integrated resource plan. See Id. at 641; see also Consumer Advocate Opening Br. at 17.

Participation in the development of a utility's integrated resource plan should allay concerns that the funding levels for various DSM measures are disconnected from the utility's portfolio of energy efficiency and other resources. Participation in the IRP process ensures that the fund administrator's views on DSM programs and funding are heard and considered. Accordingly, HECO's concerns about a non-utility third-party DSM administrator are without merit.

IV. CONSUMER ADVOCATE OPENING BRIEF ISSUES 3 AND 4 - CONCERNING THE METHOD OF COST RECOVERY, MOST PARTIES AGREE THAT DSM PROGRAM COSTS SHOULD BE RECOVERED THROUGH A SURCHARGE MECHANISM.

A. SUMMARY OF THE PARTIES' POSITION.

In its Opening Brief, the Consumer Advocate recommended that all reasonable costs associated with the administration, design, implementation, monitoring, and evaluation of utility DSM programs should be recovered through a surcharge mechanism until the Commission completes its transition to a non-utility third-party DSM market structure. Consumer Advocate Opening Br. at 34-37. DOD recommended that certain ongoing costs be recovered through base rates, with other specific program costs being recovered through a surcharge.⁷ See DOD Opening Br. at 1-3. The

⁷ Citing to the testimony of its witness, Maurice Brubaker, DOD stated that a reasonable estimate of program costs, including incentives paid to a utility's customers, should be included in a utility's base rates. DOD Opening Br. at 1-3. Direct, identifiable, difficult-to-predict, out-of-pocket expenses linked to the implementation of DSM programs should be recovered through a periodic

Consumer Advocate agrees with DOD if the utility continues to be responsible, in whole or in part, for DSM and energy efficiency programs.

RMI appears to recommend a similar approach, but RMI would have some of the internal utility costs recovered in the surcharge to the extent that the costs represent unfilled labor positions at the start of a test year. RMI has suggested that a reconciliation be performed to ensure that the incremental costs incurred to administer energy efficiency programs are recovered through the IRP surcharge. See Panel Hr'g Tr., vol. IV, 799:10-802:10, Aug. 31, 2006; see also RMI Final SOP at 17-20.

HECO and HSEA agreed that cost recovery through a surcharge mechanism is appropriate and reasonable. HECO Opening Br. at 176-77; HSEA Opening Br. at 16. HECO, however, believed that all of HECO's DSM program costs should be recovered through a surcharge mechanism. HECO Opening Br. at 176-77. TGC, the COM, HREA, LOL, and the COK took no position on the appropriate mechanism for cost recovery.

Asserting that it should be exempt from the change in market structure, KIUC stated that its current mechanism for recovering DSM program costs is appropriate and adequate. KIUC Opening Br. at 19-20. KIUC stated that a surcharge and/or base rates recover the costs of implementing DSM programs in KIUC's service territory. Id. at 20.

adjustment that reconciles actual program-related expenditures tracked by a utility. Id. at 2. DOD explained that DSM expenses are no different than any other operational cost incurred by a utility. Id. Much like fuel or purchased power expenses that are included in base rates but are subject to an adjustment as circumstances warrant, out-of-pocket DSM expenditures can be adjusted as situations change. Id. By way of example, DOD noted that incentive payments to customers will be a function of the level of customer participation. Id. DOD recognized that customer participation may be difficult to estimate. Id.

B. IN ORDER TO DETERMINE THE APPROPRIATE MECHANISM FOR COST RECOVERY, ONE MUST DETERMINE WHETHER THE UTILITY IS ENTITLED TO RECOVER ALL COSTS INCURRED TO ADMINISTER, DESIGN, IMPLEMENT AND MONITOR DSM PROGRAMS.

There is no question among the Parties that all reasonably incurred DSM costs should be eligible for cost recovery. The issue related to cost recovery ultimately reduces to whether the utility is entitled to a dollar-for-dollar recovery of costs.

The Consumer Advocate and DOD contend that it does not. As explained in DOD's Opening Brief, the rate setting process is dynamic and deals with the test year levels of revenues, costs and plant investment and the relationship of those levels to achieve a desired return on investment (i.e., return on rate base). DOD's Opening Brief presented an excellent explanation as to why normal, ongoing costs that can be estimated with some degree of certainty should be recovered through base rates, and only those incremental costs which cannot be reasonably predicted should be recovered through a surcharge mechanism. In its Opening Brief, DOD stated that a reasonable estimate of DSM program costs should be included in a utility's base rates.⁸ Furthermore, DOD stated that there should not be any "true-up" adjustment for internal HECO costs such as payroll and general office expenses because recovery of these internal HECO costs should take place in a general rate proceeding. DOD Opening Br. at 2. According to DOD, "[t]here is no reason to elevate payroll and general expenses associated with DSM programs to a higher plane than other corporate expenses." Id. at 2-3. The Consumer Advocate agrees with DOD's position.

⁸

See n.7, supra.

RMI's and HSEA's recommendation that the IRP surcharge be used as a mechanism to "true-up" the DSM program costs that are recovered through base rates to the actual costs incurred to ensure that there is no double recovery of such costs is unreasonable. RMI's and HSEA's recommendation does not recognize the manner in which costs traditionally are treated in the Commission's rate-setting processes. The rate setting process is intended to establish reasonable, normalized levels of revenues and expenses to determine a given level of income, or return on rate base. Furthermore, under the Commission's administrative rules, the costs are based on a forecasted test year. In addition, the costs are averaged and normalized for rate setting purposes. Thus, the actual amounts for specific categories of revenues, expenses and plant investment for the test year often will not exactly match the estimated levels upon which base rates are established.

This does not mean that the utility is entitled to recover or return the difference between its actual costs and the estimated costs recognized in the rate setting process. Rather, a certain amount of imperfection is anticipated and regulators recognize that a rate filing can occur if the costs and revenues, taken in the aggregate, get too far out of line with respect to the revenue requirements as determined in the last rate case. Generally, the levels of revenues, costs and plant investment that are recovered through base rates are not adjusted in the period between rate proceedings. The only time that a specific category of costs or revenues might be adjusted between base rates would be if the Commission establishes a mechanism (such as a surcharge) to deal with such variances. The Commission's practice is that a surcharge mechanism is established for only those cost items that are found to have both considerable variability

and a significant impact on the utility's ability to earn its authorized rate of return (e.g., fuel and purchased power expenses for an electric utility).

Most on-going DSM and energy-related expenditures do not fit the criteria for surcharge recovery. The costs are not of such magnitude that without the surcharge, the utility will not have an opportunity to earn its authorized rate of return if the actual cost levels exceeded the estimated levels recognized in the ratemaking process. Furthermore, there should be no "true-up" or adjustment between rate proceedings for IRP and DSM related costs because it is not possible to reasonably perform such a true-up and be assured that the utility is not directly, or indirectly, recovering such costs twice, once through base rates and again through the surcharge mechanism.

The Consumer Advocate contends that the costs a utility incurs to administer, implement and monitor DSM programs are not significant in relation to the utility's total operating costs. Thus, there is no reason to provide a utility with an opportunity to recover those normal, ongoing costs through a surcharge if the actual costs differ from the costs included in the rate setting process. Such deviations are not believed to have a significant impact on the utility's ability to earn its authorized rate of return, like the price of fuel. In this regard, fuel and purchased power costs represent more than 80% of the total operating and maintenance costs. Thus, deviations in the price of fuel or purchased power can have a significant impact on a utility's ability to earn its authorized rate of return. As a result, Commissions often allow a utility to recover or pass through

deviations in the price of fuel from the price recognized in the rate setting process through an energy adjustment clause.⁹

The Consumer Advocate notes that the impacts of any concerns with respect to potential double recovery for the HECO Companies are not applicable to KIUC because the ratepayers are essentially the members of the cooperative and any potential double recovery of expenses would generate additional monies that increase patronage capital that belongs to the members of the cooperative. This is unlike the situation for investor-owned utilities where over recovery is assumed to translate into additional profits that benefit the utility's shareholders, at the ratepayers' expense.

HREA recommends use of Public Benefits Fund ("PBF") proceeds to compensate the utility for utility incurred costs such as the costs associated with the coordination of efforts between the IRP and PBF. The Consumer Advocate notes, however, that monies deposited into the PBF should not generate funds to compensate a utility for utility incurred costs. Recovery of utility incurred costs should be realized either through the utility's base rates, or through a surcharge mechanism authorized by the Commission. Instead, the PBF should provide ratepayer funds to support non-utility third-party administration of the DSM programs, and to pay for the costs incurred by the non-utility third party provider, not the utility.

⁹ See also the concerns expressed by the Consumer Advocate regarding the potential for double recovery in the Statements of Positions filed in Docket Nos. 94-0316, 95-0362, 96-0431, 97-0358, 98-0339, 99-0338, 00-0360, 01-0409, 02-0359, 03-0276, and 04-0295 addressing the HECO Companies' request to recover certain 1995, 1996, 1997, 1998, 1999, 2000, 2001, 2002, 2003, 2004 and 2005 IRP general planning costs, respectively through the IRP surcharge mechanism and the discussion contained in the Consumer Advocate's Direct Testimony filed in Docket No. 99-0209.

If the Commission continues to allow utilities to administer, implement, and monitor energy efficiency and DSM measures, the Consumer Advocate agrees with the DOD recommendation that a utility recover the ongoing normal costs (e.g., labor costs regardless of whether a position is filed at the beginning of the test year and administrative overhead) through base rates. This would be consistent with the manner in which all other operating costs that are incurred to provide service are recovered. Only those incremental specific costs that are difficult to predict, such as program costs, equipment costs, and customer rebates that may be required to allow HECO to respond quickly to changing market conditions that could not have been anticipated in the rate proceeding should be recovered through a surcharge mechanism. The reason for this recommendation is that ongoing cost levels are relatively constant and can be predicted with some degree of certainty and the specific program costs can be isolated from the other ongoing utility incurred costs to provide service.

Should the Commission adopt the Consumer Advocate's recommendation that responsibility for the administration, implementation and monitoring of DSM measures be awarded to a non-utility third party administrator, as contemplated by Act 162, there will need to be a transition period during which utilities will retain responsibility for such efforts. During the transition period, the Consumer Advocate contends that the utility incurred costs for such efforts should be recovered through a surcharge until the transition process is completed. The reason is that once transition is complete, there will be no utility incurred DSM program costs to be recovered and the Commission can be sure that the costs previously incurred to support the DSM efforts are not being recovered in base rates.

V. CONSUMER ADVOCATE OPENING BRIEF ISSUE 5 - CONCERNING THE NECESSITY OF DSM-RELATED INCENTIVES, THE PARTIES DISAGREE AS TO WHETHER UTILITIES NEED DSM-RELATED INCENTIVES TO PURSUE ENERGY EFFICIENCY AND DSM PROGRAMS IN THEIR SERVICE TERRITORIES.

A. SUMMARY OF THE PARTIES' POSITION ON THE ISSUE.

In its Opening Brief, the Consumer Advocate recommended that the Commission terminate any incentives tied to the administration of DSM programs in Hawaii because incentives are no longer necessary to encourage utilities to pursue energy efficiency and DSM programs in their respective service territories. Consumer Advocate Opening Br. at 37-43. DOD and HREA supported the Consumer Advocate's recommendation in this respect. DOD Opening Br. at 3-7; HREA Opening Br. at 12. KIUC noted that as a not-for-profit member-owned cooperative looking out for the best interests of its membership, KIUC does not require financial incentives to pursue energy efficiency and DSM programs in KIUC's service territory. KIUC Opening Br. at 21-23.

HECO, RMI, HSEA and TGC continue to assert that incentives are necessary to encourage utilities to pursue energy efficiency and DSM measures in their respective service territories because, among other things, incentives place DSM investments on a level playing field with other supply-side options. See HECO Opening Br. at 193-95; RMI Opening Br. at 13-15; HSEA Opening Br. at 16. TGC suggested that DSM-related incentives should be provided to utilities in a manner that is consistent with the Commission's IRP Framework. TGC Opening Br. at 16-17.

B. DISCUSSION AS TO WHY INCENTIVES TO AGGRESSIVELY PURSUE THE IMPLEMENTATION OF DSM AND ENERGY EFFICIENCY MEASURES FOR THE HECO COMPANIES SHOULD BE TERMINATED.

In its Opening Brief, the Consumer Advocate discussed at great length why utilities should no longer receive any incentive to aggressively pursue DSM and energy efficiency options. The Consumer Advocate will not repeat such arguments at this time. Instead, the Consumer Advocate will expand on the reasons why the incentives proposed by HECO, RMI, HSEA and TGC are not appropriate in today's environment.

Incentives are appropriate to encourage certain actions. In determining whether incentives continue to be necessary to encourage utilities to aggressively pursue DSM measures, one should consider today's environment. In exchange for the exclusive right to provide service in a designated service area, all public utilities have an obligation to serve. Consistent with the IRP Framework, all utilities are required to consider both supply- and demand-side resources that are appropriate for fulfilling the utility's obligation to serve. This is especially so in Hawaii where the utilities are not inter-connected to one another as they are on the mainland United States. Thus, demand-side resources are necessary and critical to a utility's ability to serve its customers, especially when the utility is in need of additional generation resources.

Utilities' obligation to serve and DSM results are integral aspects of ensuring that there is sufficient generation to be able to reliably serve customers. If utilities meet their stated DSM or energy efficiency goals, there is a greater likelihood that the lights will stay on and the utilities will have done what they should have done in meeting their obligation to serve.

Given the above, Hawaii's utilities do not need an incentive to encourage the aggressive pursuit of DSM measures and have so admitted as noted by DOD in its Opening Brief. Rather, the implementation of DSM or energy efficiency measures have become an integral component in the utilities' ability to meet their service obligations.

C. PROVIDING INCENTIVES THAT ARE AKIN TO THE RETURN ON RATE BASE FAILS TO RECOGNIZE THE UNDERLYING BASIS FOR PROVIDING SUCH RETURN, IS UNREASONABLE AND IS INCONSISTENT WITH RATEMAKING PRINCIPLES.

Some of the parties, like HSEA and RMI, suggest that the utility should be provided an incentive comparable to the return on rate base as a means to encourage the utilities to aggressively pursue the implementation of DSM measures. HSEA's and RMI's recommendations are unreasonable and fail to recognize basic regulatory theory and the purpose of the rate of return allowed on rate base.

The return on rate base does not represent an incentive for the utility to acquire supply-side resources. Rather, the return on rate base represents the return that is necessary to generate funds for the acquisition of supply-side resources. In this regard, the return on rate base is synonymous with the interest that a financial institution pays on long-term cash certificates of deposit. The longer an investor's funds are held in the certificate of deposit, the higher the return in recognition that the investor does not have use of his/her funds during the period term of the certificate. Compare the interest rate on a checking account, passbook, or 20-year certificate of deposit. The interest rate typically increases with time on the premise that the funds are readily available in a checking account or passbook, but are not available for 20 years in a 20-year certificate

of deposit. In addition, investor risk, as driven by various uncertainties, increase with time, thereby supporting a higher return on investment.

DSM program costs are not the same as investment in supply-side resources. The reason is because utilities are allowed to timely recover the costs incurred to administer, implement and monitor DSM programs either through base rates, the IRP surcharge, or both. Plant costs, however, are recovered over the life of the plant, through the annual depreciation expense that is recognized in the test year revenue requirement. Thus, the utility's investor must be compensated for the fact that his/her funds will not be recovered until the plant is fully depreciated. The return on rate base represents that compensation. The return on rate base is not intended to represent an incentive to the investor to meet its service obligation.

Given the above, it is unreasonable to provide the utility with additional monies or an incentive that is akin to the return on rate base. That is not to say that the Commission cannot reward good performance or penalize poor performance by the utility by adjusting the utility's rate of return. In this regard, the Commission can provide performance rewards/penalties associated with rate of return regulation by providing additional basis points in the allowed rate of return for exemplary performance by a utility, or reducing the allowed rate of return by several basis points for non-performance. This is a well recognized regulatory reward/penalty mechanism used by Commissions in traditional rate of return regulation. This should not, however, be misconstrued to be the primary or fundamental purpose of providing a return on rate base.

HECO's proposal is not akin to the above. Rather, HECO's proposal will provide the HECO Companies with monies in addition to the return on rate base, as an incentive to pursue DSM program implementation. As discussed above, there is no need to provide additional compensation on DSM program costs because such costs are timely recovered either through base rates or the IRP surcharge mechanism. Of course, should responsibility for DSM and energy efficiency measures be transferred to a non-utility third party administrator, there will be a much diminished need to consider adjusting the HECO Companies' allowed rate of return for performance related to DSM or energy efficiency measures.

If the Commission adopts the Consumer Advocate's recommendation that responsibility for the administration, implementation and monitoring of DSM programs be assigned to a non-utility third-party administrator, the Consumer Advocate recommends that a performance-based compensation structure may be appropriate. In this regard, as HECO's consultant noted in the evidentiary hearing, if the non-utility third-party administrator does not achieve the stated goals, the administrator's compensation is reduced. If the goals are exceeded (not merely met) there could be a bonus awarded, depending on the magnitude by which the goals were exceeded.

The Consumer Advocate notes that if there is no reward/penalty allowed for non-utility third-party administration of the DSM or energy efficiency measures, there will be no means of ensuring that the third-party administrator has "responsibility" for meeting the DSM goals, unlike the utility who may risk resource deficiencies if DSM goals are not met.

D. THE CONSUMER ADVOCATE'S CONCERNS WITH HECO'S NOVEMBER 3 FILING ON DSM PROGRAM INCENTIVES--HECO'S EXHIBIT C.

1. Introduction.

On November 3, 2006, HECO filed with the Commission a letter seeking to introduce three additional exhibits in this proceeding. The Consumer Advocate finds this filing problematic for two reasons: it is untimely and the argument it tries to advance is deeply flawed.

HECO's filing would introduce additional information into the record just before the Parties' Reply Briefs are due in response to issues raised in the evidentiary hearing that was completed over two months ago. As such, this submission is untimely and the Parties have had no opportunity to explore the calculations and other information provided, or to augment the record with recommendations that may include different results. Accordingly, the Commission should not accept the additional exhibits as part of the record.

Secondly and even more problematically, Exhibit C to this filing advances a view on utility shareholder incentives associated with DSM program implementation that is unreasonable. The reasons for the Consumer Advocate's concern with Exhibit C stem from HECO's apparent perspective on shareholder incentives.

HECO appears to suggest that ratepayers should pay shareholders for earnings lost by HECO investing in cost-effective DSM instead of more costly supply options. This is untenable and would stand least cost planning on its head. The Consumer Advocate finds absurd the notion that shareholder incentives for DSM implementation

should be determined either as a function of, or in reference to, the “income stream” that a utility would achieve by pursuing a resource that is not the least cost alternative.

The concern with HECO’s proposal stems from a series of perspectives that have been advanced by the Company (and RMI during these proceedings), as evidenced by the following statements. In HECO’s discussion of shareholder incentives, HECO offers the view that aligning DSM financial and policy objectives can be done by “making investments in DSM at least as attractive as investments in supply-side options.” HECO Opening Br. at 184. HECO states in its Opening Brief that it “should not be penalized financially for implementing cost-effective DSM instead of supply-side alternatives, which are allowed returns on installed plant and facilities.” Id. at 194. The final line in the body of HECO’s Opening Brief states RMI’s view that “the goal is to assure that the utility, by virtue of implementing DSM programs, does not earn less profits....” Id. at 224.

While it is true that HECO ultimately states that the foregone return on equity would not necessarily serve as a basis for setting the utility compensation, it does use the late-filed exhibits to suggest a result that would produce substantially more compensation than the Company is requesting. Id. at 216-217. Clearly, the Company seeks to have its proposed incentives evaluated by the Commission in this context.

RMI appears to reinforce the conceptual model that HECO is advancing. It states that the utility should be rewarded for reaching a threshold level of performance with incentives that are no greater than the utility shareholder earnings on rate base (i.e., supply-side) costs that are displaced by the portfolio of DSM programs. RMI recommends that the Commission adopt HECO’s most recent revised incentive

proposal identified at the panel hearings but with one modification. RMI recommends that the incentive be limited to "the utility earnings opportunity foregone." RMI Opening Br. at 3.

2. Analysis.

The perspectives advanced by HECO and RMI paint a distorted picture of the least cost planning process that should guide the relationship between investments in supply-side options and demand-side expenditures by a utility. Followed to its logical extreme, the utility could claim that by investing in a lower cost supply option HECO is entitled to earn a bonus based on the "lost earnings" it would have had if it had been allowed to invest in a more costly option. Alternatively, HECO could argue that it should receive a bonus when it enters into a lower cost PPA as compensation for the earnings it would have received from investing in its own supply option.¹⁰

The fallacy in HECO's logic is manifest. HECO is disregarding its mandate to serve its customers in a manner that represents the lowest reasonable cost. HECO should be concerned, not that it may be deprived of profit by investing in the lowest reasonable cost option, but rather that a failure to pursue such an option may result in a penalty.

¹⁰ HECO erroneously paints a picture that its shareholders are somehow deprived when the Company makes a smaller investment. In this case HECO seems to assume that its shareholders have only two investment choices: (1) investment in a HECO supply-side option, and (2) investment in a HECO demand-side option. Of course, HECO's shareholders have many other investment options in the capital markets and may not be deprived of any earnings. Further, if HECO's shareholders are not called upon to invest more capital, then they will have less at risk.

This is not to say that some incentive for good DSM performance may not be warranted as discussed elsewhere in this brief. As indicated in its Opening Brief and in Section V.C. above, the Consumer Advocate is willing to consider compensation for exemplary performance or penalties for non-performance through adjustments to the allowed rate of return, if responsibility for the administration of DSM program implementation remains with the utilities. However, Exhibit C brings the Commission no useful information regarding what the magnitude of that incentive should be.¹¹

The Consumer Advocate is, however, troubled by the underlying message that HECO and RMI appear to be sending to the Commission. HECO and RMI appear to suggest that HECO deserves to be compensated when it chooses the least-cost resources¹² that create income streams to the Company that are lower than those that might result from other resource selections. This approach to resource planning and procurement is simply unacceptable and should be rejected by the Commission.

E. SUMMARY.

In conclusion, the Consumer Advocate submits that performance based reward/penalty compensation is appropriate for exemplary or non-performance of the

¹¹ Neither does the Consumer Advocate find the table provided in HECO's Opening Brief at 206 to be particularly instructive. The Consumer Advocate observes that this table demonstrates only that the ratio of profits to costs varies dramatically by industry. Moreover, the "costs" that HECO proposes as the basis for a calculation of profits is, in many ways, not the Company's but ratepayers'. Given the "pass through" nature of many of these costs, it is customers – not HECO – who are at risk. The rationale for having customers contribute to HECO's profitability as a function of these costs is elusive.

¹² As used in the context of this discussion, "least cost" takes into consideration other factors such as environmental benefits that may make a particular resource more costly than a fossil fuel alternative, consistent with the Commission's IRP Framework.

established DSM or energy efficiency goals. For the utilities, the Commission has the ability to consider such compensation in each rate proceeding through adjustments to the allowed rate of return. No additional funds are necessary especially funds that are intended to provide the same return as that provided for supply-side resources. The utilities' investor should not receive additional monies for the costs incurred to implement DSM or energy efficiency program measures since such costs are timely recovered either as expenses in base rates, or through the IRP surcharge, unlike plant costs, which are recovered through the depreciation expense recognized in the rate setting process.

For the non-utility third-party administrator, the reward/penalty compensation process ensures that the administrator puts at risk some portion of its compensation. Actual reward and penalty levels would depend on the level of achievement of the established DSM or energy efficiency goals. Compensation over and above program costs should only be provided for exemplary performance, and compensation of program costs should be at risk for non-performance.

VI. THE CONSUMER ADVOCATE OPPOSES REVENUE DECOUPLING.

In its Opening Brief, RMI suggested that the Commission seriously explore revenue decoupling as one of the outcomes of the Commission's Energy Efficiency Docket. RMI Opening Br. at 10-12. RMI argued that revenue decoupling removes the existing incentive for utilities to increase sales volume between rate cases and ensures that energy efficiency measures will not diminish a utility's ability to earn a fair return on its investments. Id. at 10.

DOD stated that the country's experience with revenue decoupling has been limited and unfavorable. DOD Opening Br. at 10. DOD added that disassociating revenues from sales volume effectively shifts the risk of changes in economic conditions, variations in weather patterns, and all other factors affecting sales from the utility to the customer. Id. at 9. The shifting of risk likely reduces the utility's motivation to accommodate the needs of its customer. Id.

For the aforementioned reasons, the Consumer Advocate agrees with DOD's position on revenue decoupling. Any revenue decoupling proposals should be opposed by the Commission at this time. If the Commission decides to consider such proposals, the Consumer Advocate recommends that the proposal be considered in a separate docketed matter, given the complexity of the mechanism that must be considered. Any procedural schedule established in that proceeding should take into consideration the existing procedural schedules in all pending dockets. These types of mechanisms require careful consideration and should not be rushed simply because an individual party believes that a utility requires compensation for the reduced levels of sales resulting from the implementation of DSM or energy efficiency measures.

VII. THE PARTIES AGREE THAT THE COMMISSION SHOULD APPROVE HECO'S PROPOSED DSM PROGRAMS.

A. HECO'S PROPOSED DSM PROGRAMS.

This section of the Consumer Advocate's Reply Brief addresses comments in the Opening Briefs related to HECO's proposed DSM programs. Several parties submitted comments related to HECO's proposed DSM programs, including the Consumer Advocate, HECO, HREA, HSEA and RMI. Specific comments are addressed below, as

are the Consumer Advocate's final recommendations, which may be summarized as follows:

- The Commission should approve HECO's proposed DSM programs, with the limited modifications described in the Consumer Advocate's Opening Brief, as soon as is reasonably possible, in an Order that precedes the resolution of the generic issues in this docket.
- The Commission should require HECO to make a filing within nine months of its Order approving HECO's proposed DSM programs, to address a number of related issues that need further attention (as described in detail herein). The Commission should open a docket to review this filing, allow comments from the parties, and integrate that proceeding with the annual reviews of DSM performance that the Consumer Advocate has recommended.¹³
- The Commission should require HECO to better communicate its resource planning objectives and resource needs in future IRP and DSM proceedings.
- The Commission should expect HECO to remain vigilant in its calculations of DSM program cost-effectiveness, and should require HECO to consider

¹³

The Consumer Advocate observes that there are several issues in this docket that require further attention from the Commission and from HECO. Rather than delay implementation of HECO's proposed DSM programs, the Consumer Advocate recommends a separate filing, nine months hence, that ideally would be integrated into the routine annual reviews of DSM programs that the Consumer Advocate also is recommending. The exact timing of this filing and its review by the Commission vis-à-vis the first annual review of DSM program performance and proposed program modifications would depend on a number of factors that are difficult to predict at this time.

the Consumer Advocate's recommended alternate approach to calculating avoided costs.

- The Commission should direct HECO to address: (a) possible additions to its DSM portfolio, (b) HSEA's suggestions for improvements to the REWH and RNC programs, and (c) HREA's SWAC proposal (if HREA is able to present reasonable evidence that commercial operation of SWAC systems is in fact likely to occur within roughly two years or so), as part of the filing due within nine months of its Order approving HECO's proposed DSM programs.

1. There are deficiencies in the methods by which HECO's proposed DSM program package was developed that should be remedied prospectively.

In its Opening Brief, the Consumer Advocate stated that HECO's filing fails to clearly communicate the planning objectives that its DSM programs are seeking to achieve. Consumer Advocate Opening Br. at 51. The Consumer Advocate also indicated that HECO's calculations of DSM program cost-effectiveness are flawed and should be remedied as soon as possible. Id. at 54. In particular, the Consumer Advocate identified a problem with the Participants Cost test benefit/cost ratios. Id. at 55. The Consumer Advocate emphasized that HECO should file with the Commission accurate cost-effectiveness results for all four of the tests. The Consumer Advocate also observed negative avoided costs numbers and dramatic swings in the avoided costs that were used to calculate DSM program benefits. Id. at 55-57. These large avoided cost changes resulted from the evaluation of DSM programs that each

save less than 5 MW relative to the assumed deferral of a 180 MW coal plant. Id. at 57. The Consumer Advocate offered an alternate, more stable approach to calculating avoided costs that considers the ongoing value of capacity and energy savings on a yearly basis. Id.

a. Other Parties' Positions.

In its Opening Brief, HECO addressed issues related to both its cost-effectiveness calculations, and its calculation of avoided costs. HECO discussed its approach to DSM benefit/cost tests beginning at page 53 of its Opening Brief. HECO stated that the Total Resource Cost ("TRC") is "the primary perspective that the Commission looks at in reviewing DSM programs." HECO Opening Br. at 54. HECO also committed to do an alternative calculation of avoided costs, in which the avoided capacity costs were limited to the value of a proxy combustion turbine. Id. at 60.

On November 3, 2006, HECO filed a letter in this proceeding addressing the alternate calculations. Therein, Exhibit A to that letter contains corrected calculations which are to replace benefit/cost ratios for the Participants Cost test, as provided on pages 61 and 62 of HECO's Opening Brief. HECO's November 3, 2006 filing (see Exhibit B) also contains an alternate avoided cost calculation that reflects the deferral of a proxy combustion turbine ("Proxy CT") instead of the 180 MW coal plant. See HECO Opening Br. at 60. This Proxy CT is introduced as part of an alternate calculation of avoided costs that does not have the problem of introducing negative energy costs.

RMI observes that the cost-effectiveness estimates for individual DSM programs are problematic. RMI Opening Br. at 26-27. RMI suggests that the Commission find

HECO's proposed portfolio of energy efficiency programs as being cost-effective, but should neither approve nor reject the methods or analyses used to establish cost-effectiveness. Id. at 5.

HSEA argues that HECO's DSM cost/benefit calculations should be based on the best information available today; in this regard HSEA recommends that the Commission require HECO to accelerate the three-year assessments of DSM MAP and also require HECO to use current oil price and electricity rates in its avoided cost and cost effectiveness calculations. HSEA Opening Br. at 4-5. HSEA suggests that DSM avoided cost calculations must be based on the marginal cost of peaking power. Id. at 5.

b. Discussion / Recommendations.

No party takes issue with the Consumer Advocate regarding HECO's need to better communicate its resource planning objectives, and how the objectives translate into the DSM programs proposed for implementation. Accordingly, the Consumer Advocate continues to recommend that the Commission impose requirements for greater clarity and continuity in the utility's IRP and DSM planning processes in order to facilitate the evaluation of future DSM program design activities.

Furthermore, as indicated above, during the proceeding a number of deficiencies in HECO's cost-effectiveness calculations came to light, including those related to the Participants Test. HECO believes that it has resolved the deficiencies in the Participants Test (and others) at this juncture. As will be discussed in the next section,

the Consumer Advocate is not convinced that the deficiencies have been fully addressed.

The Consumer Advocate agrees with HSEA that HECO should make every effort to incorporate up-to-date data and assumptions into its cost-effectiveness calculations. However, the Consumer Advocate would not ask the Commission to be prescriptive as to how such data and assumptions are to be developed by HECO; rather, HECO should make such determinations on a case-by-case basis, and should be prepared to defend those data and assumptions to the Commission. HSEA has raised genuine questions regarding, for example, the electricity rates used in cost-effectiveness calculations. See HSEA Opening Br. at 4-5. Rather than risk delaying implementation of HECO's proposed DSM programs, the Consumer Advocate recommends that HECO be directed to revisit its assessments of program cost-effectiveness and report (a) the results of this review and (b) the implications for HECO's DSM programs to the Commission no later than nine months from the date of the Order approving HECO's proposed DSM programs in this docket.

The Consumer Advocate observes that the use of the Proxy CT eliminates some of the problems noted when avoided costs were calculated based on a deferral of the 180 MW coal plant. Specifically and as shown in Attachment 4 to Exhibit B of the November 3 filing, avoided energy costs are no longer negative beginning in 2015. However, some fairly significant swings in avoided costs still exist. A problem also remains because the energy cost of a CT (or the differential costs calculated by HECO in its November 3 filing) may differ significantly from HECO's system energy costs – and thus the energy costs that occur during much of the year. Therefore, the Consumer

Advocate continues to recommend consideration of the alternate approach described in its Opening Brief for future analysis, which would reflect projected marginal costs of capacity and energy in each year. Consumer Advocate Opening Br. at 57-59.

As indicated above, the Consumer Advocate continues to recommend that the Commission approve the DSM programs advanced by HECO in this proceeding (except for the RCEA program). RMI similarly favors approval of HECO's proposed DSM programs, notwithstanding its concerns with the cost-effectiveness of individual DSM programs. RMI Opening Br. at 5, 25.

2. HECO's proposed programs appear to be a reasonable means of addressing HECO's current, urgent system needs and thus should be approved by the Commission.

In its Opening Brief, the Consumer Advocate recommends immediate approval of HECO's proposed DSM programs. Consumer Advocate Opening Br. at 53. While the Consumer Advocate has not been persuaded that HECO has developed an optimal DSM portfolio, under the circumstances of its reserve capacity deficiency, further delay in implementing its DSM programs would be contrary to ratepayer interests. Id. The exception to this recommendation is HECO's proposed RCEA program, which is discussed in Section 3.d., below. Id. at 59. HECO should be expected to optimize its DSM portfolio in future filings to the Commission.

a. Other Parties' Positions.

RMI also favors an interim order addressing HECO's proposed DSM programs if the Commission resolves related issues prior to resolving the broad policy questions in

this docket. RMI Opening Br. at 4. RMI argues that HECO's proposed DSM programs should be immediately approved by the Commission. However, RMI recommends that the programs be subject to ongoing review (including consideration of program accomplishments, costs and cost recovery; and reflecting any pertinent findings from the pending IRP review). Id. at 5, 23.

HSEA observes that "HECO's proposed DSM programs are both robust and of critical importance, in light of the utility's persistent reserve margin shortfall." HSEA Opening Br. at 3. HSEA supports the expedited approval of HECO's proposed DSM programs. Id. at 12.

b. Conclusions / Recommendations.

There is substantial agreement among the parties regarding the importance of moving forward to implement the DSM programs identified by HECO. The Consumer Advocate continues to recommend that the Commission act swiftly to approve HECO's proposed DSM programs, with limited modifications as discussed in the Consumer Advocate's Opening Brief. If necessary, the Commission should issue an Order approving the DSM programs before issuing an Order on the statewide policy issues, because further delay in implementing the DSM programs would be contrary to ratepayer interests. Consumer Advocate Opening Br. at 53.

The Consumer Advocate notes that during the evidentiary hearing, HECO stated that it intends to file proposed modifications to its load management programs by the end of the year. Panel Hr'g. Tr. vol. II, 314: 6-18, Aug. 29, 2006; HECO Opening Br. at 23. The Consumer Advocate looks forward to reviewing any proposed DSM program

modifications, and encourages HECO to give serious consideration to any and all strategies that can mitigate its reserve capacity shortfall.

3. The Consumer Advocate's review of DSM program designs results in limited recommendations for improvements.

The DSM program proposals that are extensions of HECO's existing and new DSM programs are generally reasonable. The exception is the RCEA program. Based on its review, the Consumer Advocate found reasonable the designs of the REWH, RNC, ESH, RLI, RDLC, CIEE, CINC, and CIDLC programs. See Consumer Advocate's Opening Br., Section III.B.1.c, (with some limited modifications) at 63.

The Consumer Advocate's recommendations regarding HECO's DSM programs are consistent with those presented in the report of the United States Environmental Protection Agency ("EPA"), *EPA Comments in Docket No. 05-0069 for the State of Hawaii Public Utilities Commission*, ("EPA Report"). The EPA Report concluded that HECO's proposed programs are generally well-designed and are cost-effective based on HECO's assumptions. EPA Report at 18.

a. Other Parties' Positions.

RMI argues that HECO should be directed to augment its DSM portfolio by promptly developing an "affordable housing residential new construction" program and a "Pay-As-You-Save" low income solar water heating and photovoltaic program. RMI Opening Br. at 24, 25.

HREA states in its Opening Brief that, "on balance ... HECO's DSM programs have benefited to date from clarity of purpose, basic consistency, predictability and have

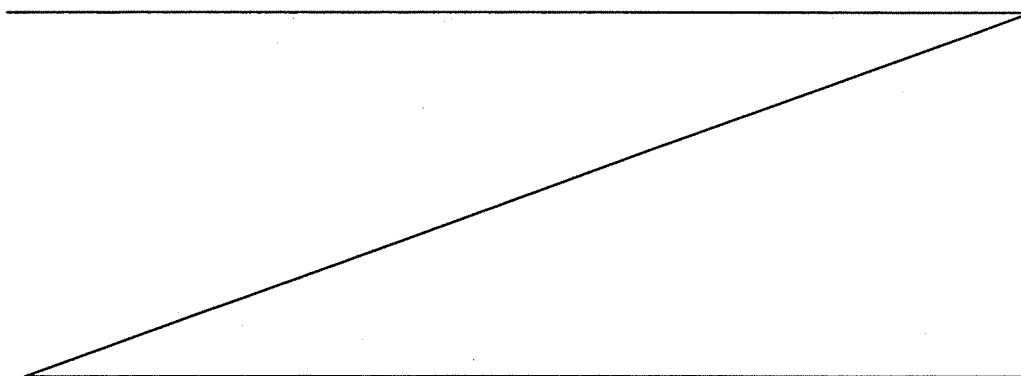
achieved support among both participants and ratepayers. This is not to say that specific aspects of individual DSM programs should not be improved, changed or reevaluated.” HREA Opening Br. at 14. HREA states that the benefits of the REWH and RNC programs are well-established. Id. HREA has concerns with HECO’s commercial and industrial programs (CIEE, CINC, and CICR), and states that not all technologies are being treated equally. Id. HREA suggests that the real costs of DSM options follow a supply curve where costs increase as increasing amounts of DSM savings are achieved. Id.

HSEA’s members are concerned that HECO’s RNC and Energy Scout programs inhibit the future installation of efficient solar water heating systems that provide capacity and energy benefits. HSEA Opening Br. at 11. HSEA suggests that it is time for HECO to augment its DSM programs by offering new programs to accelerate the deployment of solar water heating systems and other measures to underserved categories of ratepayers (including low income homeowners, renters, and the multi-family apartment and condo communities). Id. at 14.

HSEA also recommends addressing a “misalignment” between the REWH and RNC incentives and HECO’s overall DSM goals. It asserts that the RNC incentives, in particular, have driven Oahu builders and developers toward conventional water heating options that increase demands on the power system. Id. at 6, 11, 16. HSEA makes several recommendations for the Commission to consider related to the REWH and RNC programs: (1) it proposes to establish a joint industry-utility working committee to address a range of issues related to the REWH and RNC programs; (2) advertising campaigns that “drive the buying public” to HECO participating contractors; (3) higher

rebate levels (i.e., to no less than \$1,000) for solar water heaters through the REWH and RNC programs; (4) modifications to the rebate structures for the RNC program; (5) modifications to residential load control programs; (6) innovative, aggressive, targeted, and flexible new programs to accelerate the deployment of solar water heating systems and other measures to underserved categories of ratepayers, including low income homeowners, renters, and the multi-family apartment and condo communities; (7) retaining the “robust retail competition that now exists in the delivery of DSM program services. HSEA Opening Br. at 18-22. HSEA also recommends that the Commission adopt a 25-year system life in considering the cost-effectiveness of solar water heating systems. Id. at 7.

In its Opening Brief, HECO responds to questions raised by HSEA regarding programs that support measures other than solar water heating. HECO Opening Br. at 114. HECO indicates that it will increase customer incentives for solar water heaters to \$1,000. Id. at 98, 108. HECO states that it can achieve “substantial load reductions” resulting from “tank and timer” measures. Id. at 114. HECO states that solar water heaters may not be the choice of developers in all cases. Id. at 115. HECO states that customer equity issues also arise. Id.



b. Conclusions / Recommendations.

The Consumer Advocate continues to recommend Commission approval of HECO's proposed DSM programs.¹⁴ Amendments to these programs can readily occur through subsequent Commission reviews of HECO's programs.

RMI has suggested that HECO promptly develop an "affordable housing residential new construction" program and a "Pay-As-You-Save" low income solar water heating and photovoltaic program. Similarly, HSEA has suggested new programs to accelerate the deployment of solar water heating systems and other measures to underserved categories of ratepayers. A number of parties to this proceeding have recognized the importance of HECO moving swiftly to implement its proposed set of DSM programs. The Consumer Advocate recommends that the Commission place a priority on having HECO move forward with its current slate of programs, with the exception of the RCEA program. Accordingly, the Commission should approve HECO's proposed DSM programs, with the exception of the RCEA program, and HECO should move to implement them in an efficient manner.

The Consumer Advocate remains open, nonetheless, to suggestions that additional DSM programs may be effective in serving HECO's needs. As noted in its Opening Brief, the Consumer Advocate is not persuaded that HECO currently has identified an optimal DSM portfolio. Consumer Advocate Opening Br. at 53. Therefore, it is possible that one or more of the programs recommended by RMI and HSEA could effectively complement HECO's existing demand-side resource portfolio. The

¹⁴ Again, this recommendation applies to all programs except the RCEA program.

Consumer Advocate observes that the process of identifying programs and program design improvements that would best serve HECO and its ratepayers should be an ongoing one. When such improvements are identified, HECO should move quickly to implement them. Accordingly, the Consumer Advocate recommends that the Commission direct HECO to give serious consideration to the ideas raised by other parties and report back with its findings. HECO should be required to submit a filing in compliance with this directive within nine months (at the latest) of the Commission's Order in this proceeding. In addition, HECO should be directed to meet with interested stakeholders to discuss its conclusions at that time. If the Commission is persuaded that amendments to HECO's DSM portfolio are warranted, it should take action to ensure that such amendments are implemented within one year of its Order in this proceeding.¹⁵

HSEA raises interesting and challenging issues related to the incentives and the possible "misalignment" between the REWH and RNC programs. HSEA is concerned that the RNC incentives, in particular, have driven builders/developers toward conventional water heating options that increase demands on the power system. While HSEA makes several recommendations for the Commission to consider, HECO's response makes clear that there are countervailing factors that would require consideration in deciding whether modifications to the REWH and/or RNC programs are warranted. The Consumer Advocate suggests that additional information and analysis,

¹⁵ The Consumer Advocate continues to recommend annual reviews by the Commission of DSM program designs, and budgetary issues. The Commission readily could address potential modifications to the REWH and RNC programs within the context of a first such annual review.

and perhaps discussion among affected stakeholders,¹⁶ may be necessary in order to determine how best to respond to the concerns raised by HSEA. Therefore, the Consumer Advocate recommends that the Commission also direct HECO to give serious consideration to HSEA's suggestions for improvements to the REWH and RNC programs, and report back with its findings.¹⁷ HECO should be required to submit a filing in compliance with this directive within nine months of the Commission's Order in this proceeding, and should be directed to meet with interested stakeholders to discuss its conclusions at that time. If the Commission is persuaded that amendments to HECO's DSM portfolio are warranted, it should take action to ensure that such amendments are implemented within one year of its Order in this proceeding.

c. HREA's Sea Water Air Conditioning Proposal.

Included in the Consumer Advocate's Opening Brief was a discussion of HREA's requested amendment to the CICR program to address its SWAC proposal. Consumer Advocate Opening Br. at 64-67. There, the Consumer Advocate recommended that the Commission address HREA's requested increases in CICR rebates in a future proceeding, rather than in its Order in this docket. The Consumer Advocate observed that a SWAC project is unlikely to begin commercial operation in the next year or two, and thus, such a project would not have a bearing on HECO's DSM budget for some

¹⁶ The Consumer Advocate appreciates that the need for such discussion may be at the root of HSEA's recommendation for establishment of a joint industry/utility working committee.

¹⁷ The Consumer Advocate and other parties should be given an opportunity to review this filing and to provide comments to the Commission, ideally in conjunction with one of the annual reviews of DSM performance that the Consumer Advocate is recommending. Consumer Advocate Opening Br. at 70.

time to come. Id. at 65. The Consumer Advocate also noted that HREA's proposal for a \$500 per ton rebate would, for a 25,000 ton central SWAC system, cost ratepayers \$12.5 million in total rebates, more than 60 percent of HECO's total proposed budget. Id. at 40. Based on that information, the Consumer Advocate observed that the issue of commitments to a level of incentives to be paid at some future date raises difficult questions. Id. at 65. The Consumer Advocate recommended that a determination on the SWAC proposal be deferred and considered in the development of HECO's fourth IRP. Id. at 66.

HREA continues to argue that the rebates offered for sea water air conditioning ("SWAC") programs, and potentially solar air conditioning systems, are too low in relation to the potential benefits that can be achieved. HREA Opening Br. at 14-15. HREA presents the following criteria as a "test" by which the Commission should consider its request for a rebate. It asserts that the rebate should be granted if it is shown that (1) potential customers require an incentive to adopt the technology; (2) the rebate amount is sufficient to create such an incentive; (3) the rebate offer is appropriately timed to provide an incentive to prospective customers; and (4) the technology generally satisfies the utility's applicable rebate program requirements. Id. at 16. HREA addresses these criteria, and argues that its SWAC rebate request satisfies each. Id. at 16-28. HREA states that:

Downtown SWAC commercial service is expected in mid-2009. Environmental permitting, environmental impact review, final engineering, system construction and customer interconnections are scheduled to be completed by December 2007. At this time, prospective SWAC customers are actively evaluating SWAC and considering whether to enter into service agreements. Thus the rebate is needed immediately and the rebate request is timed to provide an immediate incentive.

Id. at 21.

HECO states that, “while [it] welcomes the development and installation of SWAC systems in Hawaii, at the time the DSM measure screening analysis was being conducted in the IRP-3 planning process, there was substantial uncertainty as to when it would be installed and the date commercial operations would commence.” HECO Opening Br. at 137 n.66. HECO states that the timeframe in which energy savings can be expected is uncertain at present, “including the time to sign up customers, obtain bond financing, perform environmental reviews, obtain permits, and order and install the SWAC plant and distribution system.” Id. at 138 n.67).

HECO also states that “ratepayer funded DSM programs need to strike a balance between (1) offering customer rebates to motivate customers to install energy efficient measures and/or adopt new technologies and (2) providing rebates to customers who would have installed the energy efficiency measure even without a utility DSM program. If HECO were to increase its CICR program rebate level, ratepayers could end up paying more than is necessary to [program participants] who are already being sufficiently encouraged to install DSM measures under the current rebate levels.” Id. at 141. HECO states that preliminary analysis indicates that the rebate currently available through the CICR program would be in the range of \$150 to \$230 per ton.¹⁸ HECO also states that “it is not clear, either in the documents provided by HREA or in their panel hearing testimony, why the rebate request should not be \$300 per ton rather

¹⁸ HREA states “HECO does not dispute that interconnection costs are estimated to be approximately \$300 per ton. The proposed \$150 to \$230 per ton amount is less than \$300 per ton, thus not a sufficient incentive to overcome interconnection costs and other market barriers.” HREA Opening Br. at 19.

than \$500 per ton,” if the purpose of the rebate is to offset interconnection costs (as indicated by HREA). HECO Opening Br. at 143.

The timing of the development of the SWAC proposal continues to be an important consideration. The Consumer Advocate has stated that the Commission need not address the requested rebate in this proceeding because the application of such rebate may be a number of years away. HECO also appears to question the timeframe in which a SWAC project might become operational, and also points out that the need for a rebate of the magnitude requested by HREA is an open question. While the Consumer Advocate appreciates that customer incentives might accelerate participation in a cost-effective SWAC program, the Consumer Advocate is no more interested in excessively large incentives to SWAC project participants (and/or enhancing SWAC developer profits) – at ratepayers’ expense – than it is in excessively large incentives to the utility. Importantly, questions regarding the magnitude of the necessary incentive will be affected by economic conditions as customers decide to participate in SWAC projects. Thus, ratepayers will be best served if the rebate levels (at least those toward the higher end of the scale) for SWAC projects are not set until there is reasonable evidence that commercial operation will be achieved within a year or two. Unfortunately and notwithstanding the information relayed in HREA’s Opening Brief, there remain divergent views on this matter. See HECO Opening Br. at 21 and 138 n.67; Consumer Advocate Opening Br. at 65.

The Consumer Advocate continues to find its recommendation reasonable under the circumstances. There remains uncertainty regarding the timing and feasibility of SWAC systems to serve Oahu. Even if the Commission were to commit to the rebate

level requested by HREA, that decision would be open to review by the Commission at the time that a SWAC system enters commercial operation and rebate monies begin to be paid by HECO. The extraordinary nature of this project makes it difficult to accommodate within the context of HECO's existing DSM programs.

Nonetheless, and precisely because of the substantial promise that SWAC systems appear to hold, the Consumer Advocate believes that the proposal merits close consideration in the context of HECO's IRP-4, which could be framed well before the projected IRP-4 filing date. Moreover, if HREA is able to present reasonable evidence that the commercial operation of a SWAC system is likely to be achieved within two years or so (based, for example, on permitting and construction results), the Consumer Advocate would be prepared to support immediate action before the Commission to establish appropriate incentive levels to promote rapid deployment.

- d. RCEA should not be approved as a DSM program since HECO has failed to demonstrate the cost benefits of the expenditures.**

The Consumer Advocate argues in its Opening Brief that the RCEA program not be approved by the Commission. Whether the program is offered as a DSM measure, or a general advertising measure, HECO has the burden of demonstrating the effectiveness of the program and the benefits to be derived from the program expenditures. HECO has simply failed to meet its burden of proof in this regard. HECO cites to the focus groups in support of the expenditure. The Consumer Advocate reminds the Commission that in its Statement of Position filed in Docket No. 03-0142, the Consumer Advocate noted that education by itself is not sufficient to modify

behavior. Rather than belabor the points raised regarding HECO's failure to demonstrate the cost effectiveness of the proposed expenditures, the Consumer Advocate would simply state that nothing has changed since the filing of the application in Docket No. 03-0142 and the Decision and Order No. 21756 filed on April 21, 2005 denying HECO's request.

HECO requests that, if the additional funds HECO proposed to spend for informational advertising in HECO's 2005 test year rate case are not considered in the rate case, the Commission should approve recovery of costs related to the RCEA program in this docket. HECO Opening Br. at 26. However, HECO advances no arguments to address the important concerns raised by the Consumer Advocate.

Therefore, the Consumer Advocate continues to recommend that the Commission not approve cost recovery for the RCEA program.

B. MONITORING AND EVALUATING DSM MEASURES SHOULD CONTINUE THROUGH THE INITIATION OF COMMISSION DOCKETS.

In its Opening Brief, the Consumer Advocate observed a consensus among the parties regarding the importance of monitoring and evaluating DSM efforts in Hawaii on an ongoing basis. Through its Opening Brief (at 70) and through recommendations contained in its Final Statement of Position (see particularly Appendix C at 2-4), the Consumer Advocate has advanced a straightforward process by which the Commission can ensure that DSM program performance is routinely evaluated, DSM programs are appropriately modified as knowledge is gained, and DSM program budgets are changed to accommodate DSM program changes. With the objective of enabling stakeholders to participate in these important activities in a more meaningful way, the Consumer

Advocate has recommended that the Commission open docketed proceedings to address the following on an annual basis:

- (1) electric company evaluations of DSM performance, and
- (2) proposed modifications to DSM programs with associated budget amendments.

See the Consumer Advocate's Final SOP at 2-4.

HECO states in its Opening Brief that a detailed monitoring and evaluation plan for the Company's proposed DSM programs was provided in HECO T-11 filed in Docket No. 04-0113. HECO Opening Br. at 63. HECO states that it intended to conduct a comprehensive evaluation effort during the five-year period 2007 to 2011. HECO states that the monitoring and evaluation of programs would occur approximately every three years, and that the results of the evaluations would be reported in the program modifications and evaluation reports that are currently filed annually with the Commission. HECO is proposing that DSM programs be evaluated by an independent third-party evaluator, who would be selected and compensated by the Commission. Id. at 62.

The Consumer Advocate's recommended approach is preferable to HECO's proposal and should be accepted by the Commission for the following reasons. First and foremost, DSM programs are a critical component in Hawaii's energy future. As such, the performance of DSM programs should be routinely assessed to determine whether anticipated savings levels are being achieved and whether design improvements can be introduced that yield improved results. DSM program design-implementation-review should occur continuously to ensure that Hawaii receives

optimum benefits from this important resource. Regular Commission attention to these matters also is warranted.

Second, substantial ratepayer monies are being dedicated to DSM programs. Thus, regular Commission review of the expenditures is necessary to ensure that these monies are being well-spent – particularly if ratepayers are to be asked to provide incentive payments that are to be calculated as a function of actual savings achieved. Commission action to ensure confidence that ratepayer dollars are yielding expected levels of energy and capacity savings will do much to support a long-term commitment to demand-side resources.

Third, DSM programs are important to a broad base of stakeholders in Hawaii, as evidenced by the range of participants in this docket. While it may appear “quicker and easier” if the Commission simply relies on a report from a third-party evaluator for information regarding DSM program performance, this process is not appropriate because it diminishes the opportunity for stakeholders to engage in the DSM program assessments and to present differing conclusions and recommendations.¹⁹ Hawaii will not be well-served if “independent” third parties were allowed to supplant the ability of affected stakeholders to provide input for the Commission’s consideration.

Finally, proceedings that occur once every three or more years (or only as part of IRP proceedings) create too much opportunity for lost momentum. In the time between

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The Consumer Advocate also questions the merits of HECO’s recommendation to impose the responsibility of evaluating DSM program performance on the Commission (i.e., through the introduction of a third-party DSM program evaluator hired by and funded by the Commission). The Consumer Advocate recommends that the monitoring and evaluation function should remain with the DSM program administrator, subject to review in docketed proceedings before the Commission. Moreover, IRP Advisory Group members likely will be interested in and should be kept apprised of developments related to an electric company’s DSM programs.

such reviews, staff within a utility, affected public agencies and stakeholder groups can change; key pieces of information can be lost or forgotten; and enthusiasm for important initiatives can wane. Annual docketed proceedings will help to ensure that issues in the design, implementation, monitoring and evaluation of this critical resource receive the ongoing attention that they deserve.

In addition, by opening dockets, there will be assurance to stakeholders that the Commission will review electric company filings, and will either approve or reject the presentation based on the recommendations of the Consumer Advocate, which is an ex officio party to all docketed matters, and interested stakeholders. Currently, there is no mechanism to ensure Commission action on recommendations from stakeholders that do not agree with an electric company's assessments.

Accordingly, the Consumer Advocate continues to recommend annual docketed proceedings to address DSM program evaluations, and program modifications and budgets.²⁰

VIII. CONCLUSION.

Based upon the foregoing and the Consumer Advocate's Opening Brief filed with the Commission on October 25, 2006, the Consumer Advocate respectfully requests that the Commission follow the recommendations made by the Consumer Advocate in

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The Consumer Advocate anticipates that these proceedings would become the primary forums for Hawaii's ratepayer-funded DSM activities. Some level of coordination would be required relative to IRP activities, in order to ensure that the objectives being pursued and resource needs being addressed by DSM resources remain consistent with those of the broader planning processes (i.e., IRP).

its Opening and Reply Briefs. The Consumer Advocate also requests that the Commission grant such other relief as the Commission deems necessary.

Dated: Honolulu, Hawaii, November 15, 2006.

Respectfully submitted,

By *Lane H. Tsuchiyama*
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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing **DIVISION OF CONSUMER ADVOCACY'S REPLY BRIEF** was duly served upon the following parties, by personal service, hand delivery, and/or U.S. mail, postage prepaid, and properly addressed pursuant to HAR § 6-61-21(d).

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